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IN THE

Supreme Court of the United States

October Term, 194 . No. 923.

WELSBACH ENGINEERING AND MANAGEMENT CORPORATION,

Petitioner,

v.

~~GUY T. HELVERING~~, Commissioner of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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IN THE

Supreme Court of the United States.

October Term, 194 .

No.

WELSBACH ENGINEERING AND MANAGEMENT CORPORATION,

Petitioner,

v.

~~GUY T. HELVERING~~, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Welsbach Engineering and Management Corporation, formerly Welsbach Street Illuminating Company, respectfully prays for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit to review an order of that Court entered on January 28, 1944, affirming the decision of the Tax Court of the United States.

QUESTION PRESENTED.

The question presented is:

Whether the petitioner, in determining its undistributed net income for 1936 and 1937 for the purpose of computing the surtax on undistributed profits, was entitled to a credit against adjusted net income as provided in Section

26 (c) (1) of the Revenue Act of 1936 because no distributions could be made within the taxable years as dividends without violating a provision of a written contract, expressly dealing with the payment of dividends, executed by the petitioner prior to May 1, 1936.

STATUTES AND REGULATIONS INVOLVED.

The pertinent portions of the applicable statutes and regulations are set forth in the Appendix (infra, pp. 19, 20).

SUMMARY STATEMENT OF THE MATTER INVOLVED.

On or about December 31, 1928, petitioner had outstanding $1,700,000 principal amount Collateral Trust Bonds due January 1, 1938, secured by a Collateral Trust Indenture, dated January 1, 1923, which bonds were owned by The United Gas Improvement Company (herein sometimes called United). United was then the owner of 99.4% of the stock of American Gas Company of New Jersey (herein sometimes called American), which at that time had been reduced in function to the holding of investment securities. American had no office and no organization of its own except as it was officered by the officers of United and it was contemplated that American would be dissolved as soon as certain legal questions were solved. On December 31, 1928, and as a convenience, United transferred all the bonds to American (9a, 10a, 16a-18a, 60a-62a).*

Early in 1933 petitioner was in financial difficulties and requested United to defer the current sinking fund payments on its bonds and to consent to the subordination of the lien of the Bond Indenture on certain accounts receivable to the pledge of such accounts for bank loans, including a loan from Chase National Bank (23a, 24a, 61a, 64a, 65a). United assented and agreements were entered into between petitioner and American in which petitioner covenanted not

*Numbers refer to page numbers of Petitioner's Appendix unless otherwise stated.

to pay any dividends until the sinking fund payments were fully current (24a-28a, 61a, 64a, 65a).

Later in 1933 petitioner sought from United (which then owned 99.99% of American's stock) a permanent modification of the Bond Indenture, to which United agreed upon certain conditions, including provision that no dividends should be paid without its consent (10a, 11a, 12a, 61a, 62a, 65a). As a result the following agreements and letters were executed and delivered:

1. Supplemental Indenture, dated December 29, 1933, and letter from American to Indenture Trustee, dated January 5, 1934, consenting thereto (13a, 19a, 30a, 37a, 38a).

2. Letter from petitioner to American, dated January 5, 1934, in which petitioner agreed not to pay dividends nor to increase the salaries of its executive officers without consent and to determine by mutual agreement the proper amount of depreciation for purposes of the amended sinking fund provisions. The letter reads as follows (33a, 34a):

> "261 North Broad Street,
> Philadelphia, Penna.,
> January 5, 1934.
>
> The American Gas Company,
> 1401 Arch Street,
> Philadelphia, Pa.
>
> Gentlemen:
>
> In consideration of the consent of your Company, as the holder of all of this Company's outstanding Collateral Trust Six Per Cent. Fifteen Year Sinking Fund Gold Bonds, to the execution and delivery of the Indenture dated as of December 29, 1933, supplemental to the Indenture dated as of January 1, 1923, from our Company to Fidelity Trust Company securing said bonds, we agree that so long as your Company shall hold any of said bonds that our Company will not, with-

out the prior written consent of your Company, pay any dividends on its capital stock or increase the salaries of its executive officers, either as officers of our Company or of its Subsidiary Companies, above the respective amounts of such salaries on January 1, 1934, as set forth in a list which we have delivered to Mr. W. W. Bodine, Vice-President of your Company, and that the proper amount of depreciation and obsolescence charges to be set aside by our Company and its Subsidiary Companies under the provisions of Section 2 of Article Two of said Indenture dated as of January 1, 1923, as amended, by said Supplemental Indenture, shall be determined annually by agreement with your Company.

Yours very truly,

WELSBACH STREET ILLUMINATING COMPANY

By Eugene S. Newbold
President"

Article II, Section 2, of the Bond Indenture, as amended, prescribed certain sinking fund payments based on the earnings of the petitioner and its subsidiaries for the preceding calendar year after certain deductions for depreciation and obsolescence and provided that the balance of such earnings after making the annual sinking fund payment " . . . *shall be retained by the Corporation or Subsidiary Companies for depreciation or other requirements of their business*".* Article II, Section 3, provided that the petitioner should furnish the Indenture Trustee with annual earnings statements on which the sinking fund payments were based (30a-32a).

In December, 1936, United (which then owned 100% of American's stock) caused American to be dissolved, and

*Italics supplied.

on December 24, 1936, American's assets including the $926,000 principal amount of petitioner's bonds then outstanding were distributed to United as the sole stockholder thereof (10a, 13a, 14a).

Petitioner's letter of January 5, 1934, was drafted by the legal staff of United to carry out the arrangement which the officers of petitioner negotiated with the officers of United and American. The primary interest of United was to make certain that there would be no dilution of petitioner's assets or its earnings through the payment of dividends and the provisions of Article II, Sections 2 and 3, of the Bond Indenture were buttressed by petitioner's letter. Bodine, Vice President of United and American, would not have consented to the modification if the petitioner insisted on limiting the dividend restriction to the actual period of ownership of the bonds by American. Petitioner looked upon United as the real party in interest and regarded the letter of January 5, 1934, as altogether applicable to United. The officers of United always considered the letter as extending to United. They knew of no one having questioned United's right to the benefit of the agreement nor did they know why anybody would raise any question (61a-63a, 65a, 67a, 68a).

Petitioner never tried to disregard the terms of the agreement. On the contrary in 1936 and 1937 Newbold as President of petitioner informally applied to Bodine, Vice-President of United, for permission to pay dividends but Bodine discouraged him and no formal request was ever made. Previously petitioner had had no net earnings for some years and in 1938 petitioner suffered a net loss (33a, 63a, 64a, 67a).

In accordance with the letter of January 5, 1934, petitioner, early in 1937, obtained United's approval to certain increases in executive salaries. In every year both before and after 1936, as provided in the letter, petitioner submitted to United statements of petitioner's auditors computing depreciation charges (33a-35a, 63a, 66a, 67a).

Petitioner did not declare or pay dividends during 1936 and 1937 (18a).

The petitioner claimed a credit, as provided in Section 26 (c) (1) of the Revenue Act of 1936, equal to its entire adjusted net income for 1936 and 1937 upon the grounds that no amounts could be distributed within the taxable years as dividends without violating a provision of a written contract, expressly dealing with the payment of dividends, executed by it prior to May 1, 1936, and set forth the letter agreement of January 5, 1934 (33a), as such a contract, whether considered separately or as a part of the group of contracts comprising also the supplemental indenture dated December 29, 1933 (30a) and the letter from American to the Trustee dated January 5, 1934 (37a).

The Respondent determined that the petitioner was not entitled under Section 26 (c) (1) of the Revenue Act of 1936 to any credit for either of said years by reason of contractual provisions prohibiting dividend payments (19a). The Commissioner was sustained by the Tax Court of the United States in a Memorandum Findings of Fact and Opinion of December 26, 1942 (69a-75a) and determined the deficiencies to be $33,788.21 for 1936 and $21,520.19 for 1937 (76a).

Petitioner duly petitioned the United States Circuit Court of Appeals for the Third Circuit to review the decision of the Tax Court and on January 28, 1944, the Circuit Court of Appeals affirmed the decision of the Tax Court. The opinion of the Honorable Albert Branson Maris, Circuit Judge, is printed in the record submitted herewith. (R. 77)

ERRORS ASSIGNED.

The Circuit Court of Appeals erred in holding that petitioner's letter of January 5, 1934, did not constitute a contractual prohibition against payment of dividends during the years 1936 and 1937 and in affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT.

1. The record shows by abundant clear, undisputed and wholly credible evidence that, at the time the letter agreement of January 5, 1934, was made, United, as the owner of 99.99% of the stock of American, was the real party in interest; American was but a temporary resting place for the bonds pending its dissolution then in contemplation; the dividend prohibition was intended to be for the benefit of the United enterprise, of which American was a part and petitioner, American and United, by their actions, mutually construed the agreement as having that effect; and such meaning was implicit in the objective of the agreement and all the attendant circumstances at the time the agreement was made. It having thus been established that the parties intended and construed the agreement to mean that the dividend prohibition should be in effect so long as American, or United as the real party in interest and American's prospective successor, should hold any of the bonds, the Court should have given the agreement the exact effect which the parties themselves gave to it. *Alpha Claude Neon Corporation v. Pennsylvania Distilling Company,* 325 Pa. 140; 188 Atl. 825; *Brooklyn Life Insurance Co. v. Dutcher,* 95 U. S. 269, 273. Nevertheless, both the Tax Court and the Circuit Court of Appeals held, as a matter of law, that the agreement was not ambiguous on its face and that, therefore, the dividend prohibition terminated with the transfer of the bonds to United, no matter what the intent of the parties may have been, as shown by their construction of the agreement and the surrounding circumstances. In so doing, both Courts have, at the instance of one who is collaterally attacking the agreement, applied a stricter standard than would be applied by the Pennsylvania courts between the parties under the principles governing the construction of contracts.

2. The case of *Helvering v. Ohio Leather Co. et al,* 317 U. S. 102, relied on by the Tax Court, is distinguishable.

In that case there was no history of a construction by the parties, nor any evidence of intention that the sinking fund payments should irrevocably be set aside in the calendar year in which they were earned. Having misconceived the purport of the *Ohio Leather Company* case, the Tax Court erroneously applied it to this case and failed to give consideration to the intent and meaning of the agreement apparent from the surrounding circumstances and construction of the parties. This error was not corrected and was in effect repeated by the Circuit Court of Appeals.

3. The Court below, at the instance of a stranger to the agreement, have misconstrued the law in refusing to recognize for tax purposes an agreement as to whose intent and effect the parties in interest were in entire accord and the terms of which complied with the requirements of the tax statute.

4. The Circuit Court of Appeals for the Third Circuit has adopted a position inconsistent with that of other Circuits in refusing to give any weight to the uncontradicted, credible testimony of both parties to the contract as to its meaning. It has applied the parol evidence rule despite the fact that the controversy was not between the parties to the contract. The Fifth Circuit apparently follows the same rule. *Pugh et al. v. Commissioner,* 49 Fed. 2d 76; (CCA 5, 1931) certiorari denied; 284 U. S. 642. Other Circuits and Courts, however, have adopted the contrary view. *Borin Corporation v. Commissioner,* 117 Fed. 2d 917 (CCA 6, 1941), certiorari denied, 314 U. S. 638; *American Crystal Sugar Co. v. Nicholas,* 124 Fed. 2d 477 (CCA 10, 1941); *Commissioner v. H. F. Neighbors Realty Co.,* 81 Fed. 2d 173, (CCA, 6, 1936); *Indianapolis Glove Co. v. U. S.,* 96 Fed. 2d 816, (CCA 7, 1938). This question of general law should be finally resolved.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the

Circuit Court of Appeals for the Third Circuit should be granted.

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April 20, 1944.

IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 194 .

No. .

WELSBACH ENGINEERING AND MANAGEMENT CORPORATION,

Petitioner,

v.

~~GUY T. HELVERING,~~ COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINION BELOW.

The opinion in the United States Circuit Court of Appeals for the Third Circuit is reported in 140 Fed. (2d) 584 and is printed in the record submitted herewith. (R. 77)

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered January 28, 1944. This Court has jurisdiction to review the judgment below under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, 43 Stat. 1938.

STATEMENT.

A statement of the facts, questions presented, statutes and regulations involved, and errors relied upon, will be found in the foregoing petition.

ARGUMENT.

This case turns on the question whether the phrase "so long as your Company shall hold any of said bonds" is to be given literal and narrow effect, or the meaning and effect given by those primarily concerned and implicit in their relationship and their objective.

The Tax Court and the Circuit Court of Appeals have reasoned that, since the agreement was made with American and is not ambiguous on its face, "your Company" can only mean American, and, therefore, the taxes must be paid. Stated another way, they say the phrase cannot be construed to mean "so long as your Company or its successor shall hold any of the bonds", nor can it be given comparable effect with respect to United, no matter what the other facts may be. Thus they ignore the uncontradicted testimony of Messrs. Bodine, Newbold, DellPlain, Scott and Cole, the construction of the agreement by the petitioner on the one hand and American and United as its successor on the other hand in all their actions from the inception of the agreement, and the logic and common sense of the situation (61a-68a). Thus they say in effect that these men, who made and lived with the arrangement and always regarded it as protective of United, were mistaken or misguided in not taking a contrary view in December, 1936, when American was dissolved and the bonds transferred to United.

Looking at the situation of those primarily concerned, one may not reasonably suppose that the officers of American and United, knowing that American was to be dissolved, intended to protect American and not United, or that the officers of petitioner intended to short change United as the real party in interest. The officers of petitioner never questioned United's right to such protection nor could they have done so in good conscience.

In *Chess & Wymond, Inc. v. Glenn,* 40 F. Supp. 666, aff. 132 Fed. (2d) 621, the Court in finding that there was a

written contract prohibiting the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936, stated at page 670:

> ". . . If the statute had been in existence at the time of the negotiations between the plaintiff and the bank, it would have been comparatively easy to have executed a written contract complying in every respect with the provisions of the statute and no doubt attention would have been given to precisely meeting those requirements. In such a case the formal contract should be strictly and literally construed. But the Court should consider the question from a much more liberal viewpoint when it analyzes a written agreement, informally entered into without intending to comply with any statutory requirements, because none existed, and without any thought or suggestion that it would be later tested for exact compliance with the provisions of a statute subsequently enacted and that it would be declared invalid if it did not meet that pattern in every detail. As was pointed out by Chief Justice Hughes in National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U. S. 1, at page 41, 57 S. Ct. 615, 81 L. Ed. 893, 108 A. L. R. 1352, *the Court should not shut its eyes to the plain facts and deal with the question in an intellectual vacuum.** The Court should give great weight to the fundamental rule used in construing any written instrument, namely, that it should be construed according to the intention of the contracting parties as gathered from the words of the entire instrument and from the circumstances surrounding the parties at the time when the written agreement was made. . . ."

The petitioner never contended, as the Circuit Court of Appeals seemed to think, that the term "company" generically encompasses the stockholder and, therefore,

*Italics supplied.

United, nor did the petitioner contend that the written agreement was made with United. The contention of the petitioner is that, on the basis of the admitted facts in this case, the Court may properly and should as a matter of law give the agreement the effect which the parties gave to it and that the language of the agreement does not preclude such a result.

In *Alpha Claude Neon Corporation v. Pennsylvania Distilling Co.*, 325 Pa. 140, 188 Atl. 825, the Court said:

> "The rule is here applicable that where the parties have given a certain construction to a contract by their conduct, it is evidence that such a construction was the one intended by them: Colder v. Weaver, 7 Watts 466; Gillespie v. Iseman, 210 Pa. 1; 13 C. J. 546. As this court stated in Fisher v. Ronemus, 267 Pa. 325 (p. 330):
>
> > 'Courts will, if they can, give to the contracts of parties the exact effect which the parties themselves gave to them, and interpret them just as they interpreted them: Gillespie v. Iseman, 210 Pa. 1. When the Court is asked to say what the parties meant or intended by their contract, it is entirely safe to point to their own construction of it, as evidenced by their course of dealing under it: People's Natural Gas Co. v. Braddock Wire Co., 155 Pa. 22, 25; McMillin v. Titus, 222 Pa. 500.' "

In *Brooklyn Life Insurance Co. v. Dutcher*, 95 U. S. 269, the Court said (p. 273):

> "The practical interpretation of an agreement by a party to it is always a consideration of great weight. The construction of a contract is as much a part of it as anything else. There is no surer way to find out what parties meant, than to see what they have done. Self-interest stimulates the mind to activity, and

sharpens its perspicacity. Parties in such cases often claim more, but rarely less, than they are entitled to."

In *Carthage T. P. Mills v. Village of Carthage,* 200 N. Y. 1, the Court stated (p. 14):

> "Practical construction by uniform and unquestioned acts from the outset, especially when continued for a long period of time, is entitled to great, if not controlling weight, for it shows how the parties who made the contract understood it. If they do not know what they meant, who can know? Such a construction is presumed to be right, because it was made by the parties themselves when under the influence of conflicting interests. This is true whether the construction is by contemporaries or their successors, for it is self-interest that makes the construction valuable and safe."

The Circuit Court of Appeals asserts that "the Court will not construe a contract in conflict with the plain and accepted meaning of the language used; or add words to a contract the meaning of which is clear; or hold a covenantor beyond his undertaking", citing *Hagarty v. Wm. Akers, Jr. Co. Inc.,* 342 Pa. 236, 20 A. 2d 317; *B. F. Goodrich Co. v. Wilson,* 337 Pa. 333, 10 A. 2d 422; and *Loeb v. Ferber,* 346 Pa. 348, 30 A. 2d 126. However, in each of those cases, there was a dispute between the parties to the contract as to the meaning whereas here the parties never questioned the meaning as they saw it at the time. Furthermore there is no requirement in this case that the Court hold the petitioner to a covenant beyond its undertaking, because there is no dispute between the petitioner and the bondholder as to the undertaking. The duty is to recognize the actual undertaking and not to preclude the substance in favor of a narrow and literal construction at the instance of a stranger, the tax collector. Many times this Court has said that form is not to be exalted over substance.

It is evident that in the absence of the clause "so long as your Company shall hold any of said Bonds" in the letter agreement of January 5, 1934, the Respondent would have nothing to argue. Omitting such clause, the letter would then read in condensed form:

> "In consideration of the consent of your Company, as the holder of all of this Company's outstanding Bonds, to the execution of the Supplemental Indenture, we agree that our Company will not, without the prior written consent of your Company, pay any dividends on its capital stock or increase the salaries of its executive officers, and that the proper amount of depletion charges under the Bond Indenture shall be determined annually by agreement with your Company."

This form of covenant would appear to warrant qualification to assure (1) that the prohibition against dividends and increase in salaries should not extend beyond the life of the bonds, which were being redeemed through a sinking fund, and (2) that the privilege of giving or denying consent should not be separated from the ownership of the bonds. Both objects were met by agreeing that "our Company" should not pay any dividends without the consent of "your Company", that is, of course, "so long as your Company shall hold any of said bonds." The obvious intent of the clause was not to restrict the prohibition to the life or ownership of American, but to tie it up inextricably with the life and ownership of the bonds. The usual rules as to successors in interest would then apply.

This case involves a question which goes to the heart of the problem of proof in matters before the Tax Court. The testimony of responsible officials of *both* parties to the contract embodied in the letter of January 5, 1934, was to the effect that the phrase "your Company" therein was construed by them as including the whole enterprise represented by United, and was not limited to American.

There can be no question, nor, indeed, has any been raised, as to the credibility of this testimony, which was corroborated by the practical construction of the agreement. Nevertheless, the Tax Court refused to accept the uncontradicted testimony of the parties and chose rather to base its opinion on what it deemed to be the unambiguous language of the letter stating, "the language of the agreement of January 5, 1934, expresses only one meaning to us." The Circuit Court likewise speaks of the unambiguous purport of the phrase and states:

> "The Court will not construe a contract in conflict with the plain and accepted meaning of the language used; or add words to a contract the meaning of which is clear; or hold a covenantor beyond his undertaking."

There is here no conflict of testimony with regard to the meaning of the instant agreement. *Borin Corporation v. Commissioner,* 117 Fed. 2d 917 (CCA 6, 1941), certiorari denied, 314 U. S. 638. Accordingly there is no warrant in the record for this decision, unless, by adoption of the parol evidence rule, the uncontradicted testimony must be denied effect. This rule, however, has not been deemed to apply to a proceeding between a party to the contract and a third person, in which the contract is not the basis of the obligation but is a collateral matter. *Borin Corporation v. Commissioner,* 117 Fed. 2d 917 (CCA 6, 1941), certiorari denied, 314 U. S. 638; *American Crystal Sugar Co. v. Nicholas,* 124 Fed. 2d 477 (CCA 10, 1941); *Commissioner v. H. F. Neighbors Realty Co.,* 81 Fed. 2d 173 (CCA 6, 1936); *Indianapolis Glove Co. v. U. S.,* 96 Fed. 2d 816 (CCA 7, 1938). The Third Circuit is apparently adopting a different view which it shares with the Fifth Circuit. *Pugh et al. v. Commissioner,* 49 Fed. 2d 76; (CCA 5, 1931) certiorari denied; 284 U. S. 642.

This difference in opinion between the Circuits should be resolved, as it raises the question of paramount im-

portance in all cases involving proceedings between the Government and an individual in which the construction of an agreement made by the individual with another party is important.

CONCLUSION.

We respectfully submit that the writ prayed for should be granted.

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April 20, 1944.

Appendix.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

Sec. 26. Credits of corporations.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * *

(c) *Contracts Restricting Payment of Dividends.*

(1) *Prohibition on payment of dividends.* An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

* * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26-2. *Credit in connection with contracts restricting payment of dividends.*—(a) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to

those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year; and

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings or profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936.

If a corporation is restricted with respect to the payment of dividends by two or more contract provisions coming within section 26 (c) (1), only the largest of the credits computed with respect to each of such provisions, and not their sum, shall be allowable under section 26 (c) (1) and, for such purpose, if two or more credits are equal in amount, only one shall be taken into account. However, section 26 (c) (3) provides that if both section 26 (c) (1) and section 26 (c) (2) apply, only the one of such paragraphs which allows the greater credit shall be applied, and, if the credit allowable under such paragraph is the same, only one of such paragraphs shall be applied.

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 923

WELSBACH ENGINEERING AND MANAGEMENT CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 73a–75a) is not reported. The opinion of the Circuit Court of Appeals (R. 77–82) is reported at 140 F. 2d 584.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 28, 1944. (R. 83.) Petition for writ of certiorari was filed April 24, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the provisions of the contract upon which petitioner relies restricted the payment of dividends during the tax years in question within the meaning of Section 26 (c) (1) of the Revenue Act of 1936.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 26. CREDITS OF CORPORATIONS.
>
> In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—
>
> * * * * *
>
> (c) *Contracts Restricting Payment of Dividends.*—(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.
>
> * * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26–2. *Credit in connection with contracts restricting payment of dividends.*— (a) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year; and

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings or profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936.

If a corporation is restricted with respect to the payment of dividends by two or more contract provisions coming within section 26 (c) (1), only the largest of the credits computed with respect to each of

such provisions, and not their sum, shall be allowable under section 26 (c) (1) and, for such purpose, if two or more credits are equal in amount, only one shall be taken into account. However, section 26 (c) (3) provides that if both section 26 (c) (1) and section 26 (c) (2) apply, only the one of such paragraphs which allows the greater credit shall be applied, and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied.

* * * * *

STATEMENT

The pertinent facts as found by the Tax Court (R. 69a–73a) may be summarized as follows:

Petitioner is a Delaware corporation doing business in Pennsylvania (R. 69a).

From 1928 to December 24, 1936, all of petitioner's outstanding bonds of an original issue of $2,400,000, were owned by The American Gas Company, hereinafter referred to as American. This company had ceased activities in 1927 except as a holding company. From that year to 1936 practically all of its outstanding stock was owned by United Gas Improvement Company, hereinafter referred to as United. In 1936 the small outstanding balance of American stock was acquired by United, and in December of that year it was the owner of all the issued stock of American. (R. 70a.)

Petitioner's bonds hereinbefore referred to were issued under a trust indenture covering all of its assets and properties. By the terms of the indenture it was obligated to make annual payments to the trustees for purposes of a sinking fund in the sum of $106,000 payable semiannually in equal installments. (R. 70a.)

Petitioner was indebted to the Chase National Bank of New York in the sum of $250,000, representing loans made to petitioner for the purpose of meeting current expenses. In January, 1933, the bank demanded payment of this indebtedness and petitioner thereupon proceeded to make arrangements to meet the situation. It entered into negotiations with American for modification of the conditions of the aforementioned trust indenture to permit the deferment of the sinking fund's payment due in 1934, and for the release of certain of its assets from the trust, in order that they might be placed with the bank in securing an extension of the loan. These negotiations were carried on with the officers of American who were also officers and directors of United, and the several agreements resulting therefrom were prepared under the direction of United's general counsel. (R. 70–71a.)

The arrangement ultimately effected was that American agreed to a deferment of the sinking fund payments for 1934, and to a modification of the trust indenture covering the bond issue.

Under the modification of the trust indenture, petitioner was required to and did enter into a contract restricting payment of dividends and any increase in its officers' salaries. This agreement was prepared under the direction of the general counsel of United acting for American, and was embodied in a letter addressed to American dated January 5, 1934, delivered to American (R. 71a) and reading as follows (R. 72a):

261 North Broad Street,
Philadelphia, Penna.,
January 5, 1934.

The American Gas Company,
1401 Arch Street, Philadelphia, Pa.

Gentlemen: In consideration of the consent of your Company, as the holder of all of this Company's outstanding Collateral Trust Six Per Cent. Fifteen Year Sinking Fund Gold Bonds, to the execution and delivery of the Indenture dated as of December 29, 1933, supplemental to the Indenture dated as of January 1, 1923, from our Company to Fidelity Trust Company securing said bonds, we agree that so long as your Company shall hold any of said bonds that our Company will not, without the prior written consent of your Company, pay any dividends on its capital stock or increase the salaries of its executive officers, either as officers of our Company or of its Subsidiary Companies, above the respective amounts of such salaries on

January 1, 1934, as set forth in a list which we have delivered to Mr. W. W. Bodine, Vice-President of your Company, and that the proper amount of depreciation and obsoleseence [obsolescence] charges to be set aside by our Company and its Subsidiary Companies under the provisions of Section 2 of Article Two of said Indenture dated as of January 1, 1923, as amended by said Supplemental Indenture, shall be determined annually by agreement with your Company.

Yours very truly,

WELSBACH STREET ILLUMINATING COMPANY,

By, [s] EUGENE S. NEWBOLD,

President.

On January 5, 1934, petitioner's directors authorized the execution of the supplemental modified trust indenture and the signing of the above letter by petitioner's president on its behalf. On December 8, 1936, the stockholders of American voted for its dissolution. Thereafter on December 24, 1936, all of its assets including all of petitioner's bonds then outstanding and in the amount of $926,000 were transferred and distributed to United, American's sole stockholder. (R. 73a.)

The Tax Court held that petitioner was not entitled to credit against its adjusted net income under the provisions of Section 26 (c) (1) of the Revenue Act of 1936. The court said that

since the restriction on dividends, contained in petitioner's letter of January 5, 1934, to American, was in terms to endure only so long as American held any of the bonds, the restriction was removed when American was dissolved and its assets taken over by United on December 24, 1936, a date prior to the close of the first taxable year for which petitioner claims the benefit of the statutory credit. (R. 73a–75a.) The Circuit Court of Appeals affirmed (R. 77–83).

ARGUMENT

There is no occasion for further review of this case. It was correctly decided below, and presents no question of conflict among the circuit court of appeals. Petitioner concedes (Pet. 12) that the case "turns on" the construction of a clause in the letter quoted above, an issue obviously not of general importance.

Section 26 (c) (1) of the Revenue Act of 1936, in so far as pertinent here, allows a credit for so much of its net income as a corporation is prohibited by contract from paying out as dividends.[1] The restrictive provision embodied in the letter of January 5, 1934, would have enabled petitioner to take advantage of this section if the contract had remained in effect. But by its terms the critical covenant was to endure only so long as American held any of petitioner's

[1] Later revenue laws contain no provision corresponding to Section 26 (c) (1) of the 1936 Act.

bonds, and American ceased to hold any of the issue prior to the close of the first of the tax years here involved.[2] Thus the contract provision restricting dividend payments on which petitioner's case rests was not operative during the tax years for which the credit is asserted. That petitioner continued to deem itself bound by the covenant is, of course, entirely immaterial. *Helvering* v. *Magnus Beck Brewing Co.*, 132 F. 2d 379 (C. C. A. 2d), certiorari denied, 319 U. S. 749. See also *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102.

The gravamen of petitioner's case is that the duration of the restrictive provision was coextensive with the holding of the bonds directly or indirectly by United, the parent corporation. But as the court below held, there is no justification for that contention in the terms of the pivotal letter, which is addressed to the subsidiary as the holder of the bonds and plainly conditions the agreement not to pay dividends upon a continued holding of the bonds by American. (R. 72a). Such unambiguity stood in need of no "interpretation;" and manifestly it was not the function of either the Tax Court or of the court below to "construe" a different contract from that which the parties had made for themselves. Particularly is this so in a case

[2] Obviously the restriction upon payment of dividends must endure throughout the entire tax year if it is to prevent distribution "within the taxable year."

involving a "special credit in the nature of a deduction". *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102, 106.

Contrary to the position which petitioner takes here, neither the Tax Court nor the Circuit Court of Appeals rested its decision on the ground that as a matter of law the language of the letter alone bespoke the parties' agreement; we do not need to consider whether, as urged (Pet. 8, Br. 17), there exists some division of opinion among the Circuits with respect to the applicability of the parole evidence rule in a proceeding of this kind. For it is plain from the Tax Court's findings and opinion (R. 69a–75a) that it *did* admit and consider all of the "parole evidence" adduced by petitioner in aid of its contention that United was the real party at interest to this contract, and thus that the restriction against dividends "carried over" beyond the cessation of holding by American. It is equally plain in the opinion below (R. 80) that the Circuit Court of Appeals recognized the materiality of other elements besides the terminology of the critical letter. Fundamentally, the petitioner's complaint is only that its contention was rejected on evidence, *including* the letter, which pointed to the conclusion that American was the contracting party, and that the agreement meant what it so unequivocally said—and no more. But, of course, the Tax Court was entitled to choose among conflicting inferences, and certainly the evidence in

support of its determination was sufficiently substantial to conclude the matter in the court below.[3] *Dobson* v. *Commissioner,* 320 U. S. 489; *Helvering* v. *Stock Yards Co.,* 318 U. S. 693; *Wilmington Co.* v. *Helvering,* 316 U. S. 164.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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MAY 1944.

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[3] Thus, as opposed to the testimony of petitioner's officers and those of United that the parties intended United as the covenantee of the restrictive provision, the documentary history of this transaction tended to show that both petitioner and United contemporaneously regarded American as owner of the bonds and the contracting party. United, to whom the bonds were originally issued, transferred them to American in 1928 (R. 70a); it was to American, not to United, that petitioner first wrote requesting deferment of payment under the trust indenture (R. 24a–25a). Likewise, it was American, not United, which signed the agreement permitting subordination of the indenture lien to the bank loans which petitioner was negotiating; and it was American, not United, which by appropriate resolution consented to execution of an amendment to the original sinking fund provisions. (R. 30a–32a, 36.)

U. S. GOVERNMENT PRINTING OFFICE: 1944